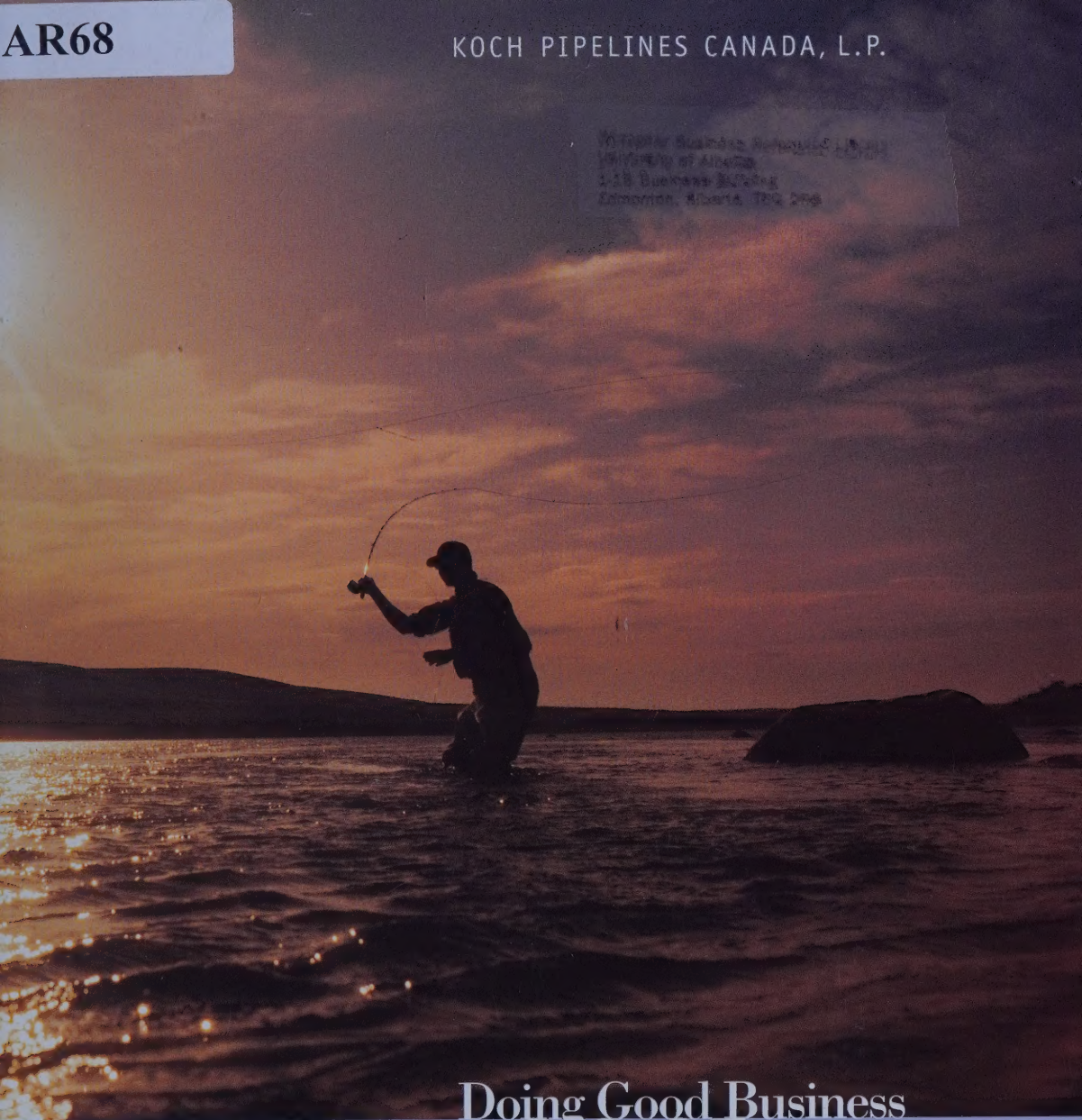


Walter Gaudin, President, L.P.  
University of Alberta  
1-18 Business Building  
Edmonton, Alberta, T6G 2G6



Doing Good Business  
**2001**  
ANNUAL REPORT

“At Koch we are proving companies can grow and prosper without sacrificing the environment.”

## Doing Good Business

*Koch Pipelines Canada, L.P. ("Koch") owns and operates one of Canada's largest crude oil feeder pipeline systems.*

*At Koch, we're ambitious. We are resolved to be one of Canada's premier income funds. To do this we will provide our customers with safe, reliable transportation and product handling services; we will strive to extract the potential of every one of our assets; we will manage our capital resources to protect and grow your investment; and we will conduct our business in full compliance with safety and environmental standards, respectful of the communities in which we operate.*

## About the Cover

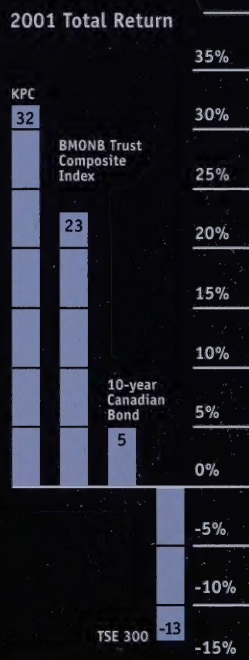
*This stretch of the Bow River in southeastern Alberta flows on undisturbed by the new pipeline buried beneath the riverbed. Koch's 2001 Bow River Southbound Expansion is shipping record volumes to new markets and returning excellent value to unitholders as well as proving Koch can expand and grow without sacrificing safety or harming the environment. On page nine of this report, we illustrate the techniques we used to expand this system without disturbing our neighbours.*

**Advisory** Certain information regarding the Partnership contained herein may constitute forward-looking statements under applicable securities law. Such information, although considered reasonable by the General Partner at the time of preparation, may prove to be incorrect and actual results may differ materially from those anticipated in the forward-looking statements.

The Partnership's Class A units may only be held by Canadian residents. In the event that the Partnership's Class A units are acquired by a non-resident of Canada, the General Partner has the authority to take appropriate steps to ensure that such units are transferred to a Canadian resident. Investment in the Class A units is regarded as foreign content for registered retirement savings plan, registered retirement income funds and deferred profit sharing plan purposes.

## Contents

1	Financial Highlights
2	Koch at a Glance 2001
4	Message to Unitholders
9	Bow River Southbound Expansion
14	Management's Discussion and Analysis
20	Financial Statements
29	Unitholders' Tax Allocation
30	Corporate Governance
31	Partnership Information
IBC	Partnership Profile & Abbreviations



Source: BMO Nesbitt Burns Inc. ("BMONB")

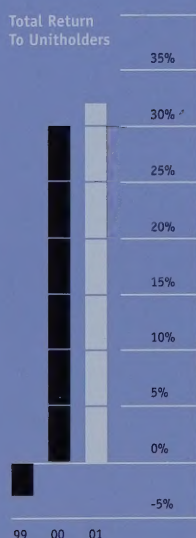
## FINANCIAL HIGHLIGHTS

(\$ thousands except per unit amounts)

	2001	2000
Throughput volume (Mbb/d)	235.0	248.2
Revenue	\$ 92,050	\$ 83,133
Operating expenses	(33,999)	(25,614)
General and administrative expenses	(4,045)	(3,750)
Net income	8,151	8,775
Capital expenditures incurred	(22,649)	(5,819)
Investment in Cold Lake		
Pipeline Limited Partnership	(47,628)	(2,338)
Reserve to be used for capital and maintenance		
projects and future distributions	( 1,099)	( 3,252)
Distributable Cash paid/payable	49,776	48,312
Per Class A and B unit amounts:		
Net income	\$ 0.11	\$ 0.12
Distributable Cash paid/payable	\$ 0.68	\$ 0.66

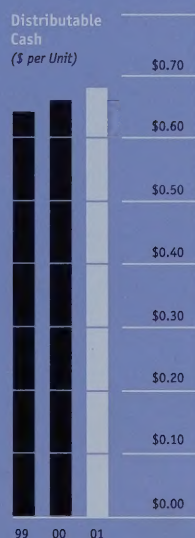
# Financial Highlights

**Q: Why invest in Koch?**



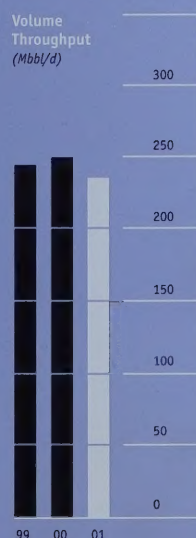
**A: In 2001, Koch realized a 32% total return to unitholders.**

**Q: As a unitholder what can I expect?**



**A: Stable, reliable distributions.**

**Q: What about volume declines on your system?**



**A: Our total return to unitholders increased even though volumes declined 5% during the year.**

### **Bow River Pipeline System**

*Length: 2,758 km (1,724 miles)  
Capacity: 260 Mbb/d  
2001 Throughput: 155.1 Mbb/d*

This major pipeline system gathers and transports Bow River stream and light sour crude oil from producing fields in southeastern Alberta for delivery north to the Gibson Terminal at Hardisty, Alberta, and south for delivery to refineries in the United States through a connection with the Plains Marketing Canada L.P. pipeline at Milk River, Alberta.

### **Koch Valley Pipeline System**

*Length: 242 km (151 miles)  
Capacity: 12.1 Mbb/d  
2001 Throughput: 6.5 Mbb/d*

A condensate feeder pipeline system in southwestern Alberta, this pipeline receives condensate originating at the Shell Waterton Gas Plant, the Shell Jumping Pound Gas Plant and the Petro-Canada Wildcat Hills Gas Plant for delivery to Pembina's Cremona Pipeline at Madden.

Koch Pipelines Canada, L.P., a publicly traded income fund, owns and operates four Canadian pipeline systems. Koch's oil pipeline systems form the heart of crude oil gathering and transportation within southern Alberta and Saskatchewan, and connect to transmission lines accessing refiners across Canada as well as the United States. Our combined 4,100 kilometre crude oil feeder pipeline system, one of Canada's largest, gathers crude oil from producer-owned production treating facilities for delivery to regional refineries or export pipelines.

# Koch at a Glance 2001

### **Koch Alberta Pipeline System**

*Length: 538 km (336 miles)  
Capacity: 73.9 Mbb/d  
2001 Throughput: 36.4 Mbb/d*

This major crude oil feeder pipeline and gathering system collects light sour crude oil from producing fields in south-central Alberta for delivery to Edmonton.

### **Mid-Saskatchewan Pipeline System**

*Length: 555 km (347 miles)  
Capacity: 63.2 Mbb/d  
2001 Throughput: 37.0 Mbb/d*

This major crude oil pipeline and gathering system collects heavy blend and light sweet crude oil.

### **Cold Lake Pipeline System**

*Length: 560 km (348 miles)  
Capacity: 430 Mbb/d*

Koch holds a 15% share in the Cold Lake Pipeline Limited Partnership. This Partnership owns the Cold Lake Pipeline System that is designed to move heavy oil from the Cold Lake region of Alberta to terminals at Hardisty and Edmonton.



# Financial

- We continued our record of stable, reliable returns by distributing \$49.8 million, or \$0.68 per unit, an increase of \$1.5 million, or \$0.02 per unit, over the previous year.
- Distributable cash generated in 2001 was \$50.9 million, or \$0.70 per unit.
- We improved our revenue per barrel by \$0.15 to \$1.07 from \$0.92 in 2000.

# Operational

- We completed the \$14 million Bow River Southbound Expansion strengthening Koch's position as the primary long-term supplier to the Montana refinery market.
- On December 21, 2001, the Cold Lake Pipeline Limited Partnership commenced shipping on the recently constructed, 235-kilometre blend transmission line between LaCorey and Hardisty, Alberta.

# Environment, Health & Safety

- We celebrated our sixth year in a row with zero lost time accidents; Koch employees have now worked approximately 915,000 person-hours without a lost time accident.
- Koch has been recognized as a "Gold Level" participant in the Canadian Association of Petroleum Producer's Environmental Health & Safety Stewardship Program.
- We received an Alberta Oil and Gas Pipeline Operators Safety Council award from Alberta Human Resources & Employment for zero lost time accidents for the year. This was the fourth year in a row we have received this award.
- Our accidental releases from pipelines, in terms of volume, were 18% lower than in 2000.



**Q:** *How did revenue grow despite lower throughput volumes?*

**A:** *We have improved revenue per barrel; up \$0.15 per barrel during the year.*



## In an uncertain world, Koch strives for stability.

When our customers, unitholders, neighbours and other stakeholders describe Koch as stable and reliable, we take it as a compliment. In fact our team works hard to ensure our operations, community relations and distributions remain stable and reliable for the long-term.

That's why we're especially proud of our work during 2001.

### Our 2001 financial and operating results were the best ever in our history

We broke several corporate records for the year. In 2001, Koch delivered a total investment return of 32% to our unitholders compared to 30% in 2000. Our distributions to unitholders were \$49.8 million, or \$0.68 per unit, up \$0.02 cents per unit from 2000. Koch's revenue grew 11% to \$92.1 million even though our volumes declined 5% during

# Message to Unitholders

the year. Average revenue per barrel increased to \$1.07 from \$0.92 in 2000. We think you will agree that our determined focus on value creation has delivered stable results, year over year. More importantly, we have consistently strengthened Koch's operations to help maintain reliable returns to unitholders.

In the current economic environment, this level of performance is no accident: it takes commitment, skill and focus. Today energy commodity price cycles are increasingly volatile. While this lends an uncertainty to the energy business, it also creates opportunity. At Koch, we believe that a strong balance sheet, prudent management and well-maintained assets create a hedge against uncertainty; these coupled with the ability to innovate and to capture opportunities are our recipe for success in uncertain times. In 2001, we used this recipe to deliver some of the best results in our industry.

But we never lost sight of tomorrow.

### **We also laid the foundation for Koch's continued growth and prosperity**

We did this by expanding the southbound capacity of the Bow River Pipeline System by 25,000 barrels per day to enable us to transport 118,000 barrels per day to a growing refining market in Billings, Montana. We did this by committing to a long-term asset integrity program that will help ensure the operational reliability of our pipeline systems for generations to come. We did this by completing a tank upgrade program that now provides over 450,000 barrels of storage capacity in Alberta. We did this by investing \$50 million in the Cold Lake Pipeline Limited Partnership, owners of Canada's largest heavy oil gathering pipeline which is strategically positioned to service the fast-growing oil sands region of east central Alberta. In 2002, we anticipate our 15% investment in the Cold Lake Pipeline Limited Partnership will contribute \$6.2 million to cash flow. We laid the foundation for continued growth and prosperity by devising innovative, economical solutions to business challenges. And we did this the way we have always done things at Koch — quietly and respectful of our neighbours and the environment in which we operate. On page 9 of this report, we show how we completed the expansion of our Bow River Pipeline System in a way that minimized disruptions to our neighbours.

Of course the year had its challenges. Due to a combination of factors our operating costs were up and our volumes were down.

During 2001, as declining crude oil prices and the wide light-to-heavy crude oil price differential caused some producers to shut in wells, delay production and wait for a better price environment, drilling activity in Koch's service corridors decreased compared to the previous year. At the same time, relatively higher gas prices particularly at the start of the year, created more producer focus on natural gas activity.

### **We are now transporting product more profitably than ever before**

That's because, along with diligent toll management, Koch continually surveys the market to ensure our assets are deployed for maximum return. We have built new infrastructure to tie in areas of significant new production; we have expanded our system to provide greater access to growing markets; and we have rationalized our portfolio by suspending operations of unprofitable assets and by transforming and redeploying assets to derive maximum value for unitholders.

For example, we have grown our high profit volumes on the Bow River Pipeline System by developing the new Suffield pipeline and completing a 15,000 barrel-per-day capacity expansion of the Jenner lateral. These expansions have connected significant new production from the Jenner and Suffield areas. Production from this area is also helping to serve demand growth to the south in Billings, Montana and offset volume declines from more mature service areas.

Our recent expansion of the Bow River Pipeline System increases our capacity to supply southbound crude and capture an excellent opportunity to deliver incremental barrels to the Montana refineries. This not only provides our producer customers access to this growing market, it also gives our refining customers in the United States access to a reliable long-life supply of Canadian crude.

Long-term, we anticipate Koch's Bow River Pipeline System will evolve into a high return transmission pipeline with delivery points at both Hardisty in the north and the U.S. border to the south. In fact, we have already auctioned 9,200 barrels per day of capacity to shippers on our Bow River Pipeline System to support a pipeline reversal between Hardisty and Princess and we expect to be shipping from Hardisty by July 2002. If there is sufficient future demand, a modest investment can increase capacity to 17,100 barrels per day.

Access to Hardisty will reduce the reliance on gathered volumes in our existing service areas, expand supply availability, and transform this system from a gathering system into a lower operational cost, high profit transmission line. This is an excellent example of how we creatively redeploy our assets to add value to your investment.

#### **Volume declines have not decreased our revenues**

While we experienced a 5% volume decrease on the Koch systems in 2001, that's just part of the story. It is important to understand that it is not volumes transported that is critical to our continued profitability, but the profit we are able to derive from our transportation services. And we are absolutely focused on maximizing profit.

Crude oil receipt and delivery patterns are constantly changing within our service areas. We closely monitor these market dynamics to understand and anticipate ways our pipeline and storage assets can be redeployed to enhance profitability. We also continually assess the return from each of our assets to determine if they are adding full value. Part of the volume that was eliminated from our system over the past year was simply not adding value to your investment. For example 7,500 barrels per day from the Hardisty Truck Terminal was unprofitable for Koch to transport and we suspended operations at this facility. Across our system, we have initiated a rationalization program to optimize unprofitable laterals either through toll increases, volume commitments or by divesting them altogether.

As well as ensuring that each asset is deployed to maximize returns, Koch also focuses on protecting and conserving our asset portfolio through our asset integrity program.

### **Our operational costs help to ensure long-term asset reliability and stability of distributions**

In the coming year, we plan to advance Koch's pipeline inspection and repair program. While this program is costly, we consider maintaining the integrity of our assets to be a valuable investment in the future. Not only does this program maintain the daily reliability of our operations and prolong the life of our system, it is key to delivering stable distributions to unitholders. It's also important to understand that costs associated with our recent asset integrity programs have been offset by toll increases.

### **We're efficiently deploying capital for Koch's future**

In 2001, Koch spent \$70.3 million growing our business. We spent \$47.6 million on the Cold Lake investment, \$14.1 million on the Bow River Southbound Expansion and \$4.7 million on the Suffield and Jenner expansions. These are significant investments in Koch's future — on a dollar value basis but even more importantly, for their long-term strategic value.

Koch management sets a very high standard in considering acquisition or expansion opportunities; we will only invest in opportunities that are accretive to unitholders. We are resolved to search for the most economical, cost-effective means of capturing opportunities in order to ensure unitholders receive the maximum possible return on their investment for the least amount of risk.

Our investment in the Cold Lake Pipeline Limited Partnership strategically positions Koch to participate in the oil sands mega-projects in east central Alberta, an extremely active area, where current pipeline capacity is clearly insufficient for the long-term. As well, for a minimal investment, we expanded the Bow River Pipeline System, strengthening our position as the primary long-term supplier to the Montana refinery market. In less than a year of operation, this investment has already returned excellent value to our unitholders.

### **Koch takes pride in your neighbourhood**

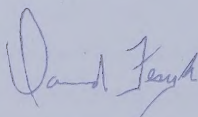
We believe that it is our corporate responsibility to leave the smallest footprint possible in our operations. On the following pages, we illustrate how we constructed 46 kilometers (28 miles) of pipeline for 2001's Bow River Southbound Expansion project without unnecessary disturbance to the people, rivers, habitat or wildlife in the construction corridors. At Koch we are as proud of our relationships in the community as we are of our financial and operating results. We are proving companies can grow and prosper without sacrificing safety or harming the environment. For the people of Koch that's not just good business, it's our business.

### The future looks bright

I began this message by stating our belief that a strong balance sheet, prudent management and well maintained assets help create a hedge against the uncertainty inherent in our industry. It is difficult to predict whether recent improvements in producer wellhead netback prices will translate into higher throughput volumes on our systems. Despite this uncertainty, Koch is well positioned to add to its track record of stable financial performance. This stability will come from the improved profitability of our operations and the cash flow contributions from our recent growth investments.

In the longer term, we believe Koch will remain the top-performing income fund it is today. We believe this because our conservative distribution policy and our strong balance sheet have ensured Koch has the capital resources available to secure expansion, acquisition and other investment opportunities. We believe this because the Koch team has the vision and resolve to find and capture value for unitholders. And we believe this because we are absolutely focused on protecting and growing your investment.

Thank you for your continued confidence in me, and my colleagues at Koch.



DAVID W. FESYK

*President and Chief Executive Officer*

Koch Pipelines Canada Ltd.

March 10, 2002



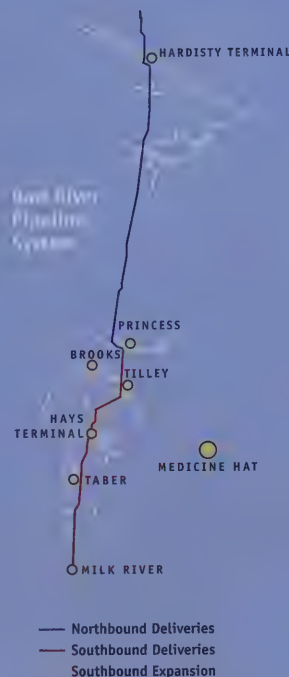
# The Bow River

## Southbound Expansion

**C**an you build a pipeline without being noticed? The people at Koch believe that you can.

When it came time to expand the Bow River Pipeline System to ship additional Canadian crude to Montana refineries, Koch's corporate commitment was clear: leave the smallest footprint possible on the grasslands of southeast Alberta. Our engineers were confident they could build a pipeline without disturbing the people living near the construction corridor. This is the story of how the Koch team worked hard to minimize disruption for their neighbours.

So, did the neighbours notice when the pipeline came to town? At Koch we're pleased to say, "Not much".



**Tailgate Safety Meeting:** Prior to construction, all contractors attended a kick-off meeting where they received a thorough safety and environmental briefing. Koch is determined to construct all pipelines safely, and to the finest quality.



Over the past decade, as the oil producing regions in the United States have matured, demand has increased for Canadian crude. Several years ago the Koch team identified an opportunity for the Partnership to economically expand the Bow River Pipeline System and carry additional product south to Montana refineries.

The Partnership developed a strategy to expand the Bow River Pipeline System in stages starting with the Princess Reconfiguration in 1999, which increased capacity by 22,000 barrels per day. In 2001, Koch tied in significant new production from the Jenner and Suffield areas, with the construction of the Suffield pipeline and a 15,000 barrel-per-day capacity expansion of the Jenner lateral. In July 2001, the Partnership completed

the most recent phase of the expansion program: the construction of the Hays and Warner Loops, expanding capacity by 25,000 to 118,000 barrels per day.

"In expanding the Bow River Pipeline System we saw a great opportunity to capture significant value for our unitholders through a relatively small investment," said David Fesyk, Koch's President and Chief Executive Officer, adding that Koch anticipates future expansions to this system. "Because Koch is in this business for the long haul, we recognize how important it is to grow in a way that is cognisant of our landowners. Since we value our relationships with our neighbours, we are pleased to work with them to ensure our projects are completed as discreetly as possible."



A project of this magnitude requires a teaming of highly qualified people. A team of geologists, biologists, engineers, and other experts in the field of construction

### Planning to go unnoticed

A team of environmental, geological, engineering, construction and drilling experts mobilized to plan the construction and execute it as inconspicuously as possible. For the most part, the expansion would follow Koch's current corridor, where two 8" pipelines were buried. Because this corridor had been created decades ago however, a thorough field reconnaissance was conducted to determine the optimum routing for the expansion.

Environmental and archaeological consultants scouted the proposed route and identified areas of special historical or biological significance. Meanwhile Koch, in consultation with local communities, the Eastern Irrigation District (the largest landowner on the Hays portion of the expansion), the Bow River Irrigation District and other landowners, established the timing and final route.

The Eastern Irrigation District had recently implemented new regulations restricting construction to a narrow window in the months of April and May — just after spring break up but before the

development of new grass. This timing ensured that construction dust didn't settle and choke the new shoots.

According to Glen Brown of the Bow River Irrigation District, Koch went the extra mile in planning the project. "In one area, where Koch's planned route crossed an irrigated pasture, they decided to bore under the pasture. This avoided disturbing the area altogether. They didn't have to do that, but we were very impressed they did."

BELOW: Valves and the line, providing the pressure that the construction workers have to dig, maintain the pipeline.





The routing on the Southbound Expansion required that Koch cross the Bow River, the most significant waterway in southern Alberta, and also one of the finest fly fishing rivers in the world. For Allan Ross, Koch's Project Manager on the Southbound Expansion the solution was obvious.

"We decided on a directional drill across the Bow." Allan said. "We planned to drill approximately 50 metres below the riverbed, at a narrow point of the river leaving the fish and wildlife on the banks of the Bow undisturbed by the construction." At the spot selected, the banks were high above the river and the entire span of the bore would stretch 1,000 metres.

At the point, only 100 metres from the riverbed, the pipeline was installed. The pipeline was installed at a depth of 50 metres below the riverbed. The pipeline was installed at a depth of 50 metres below the riverbed.

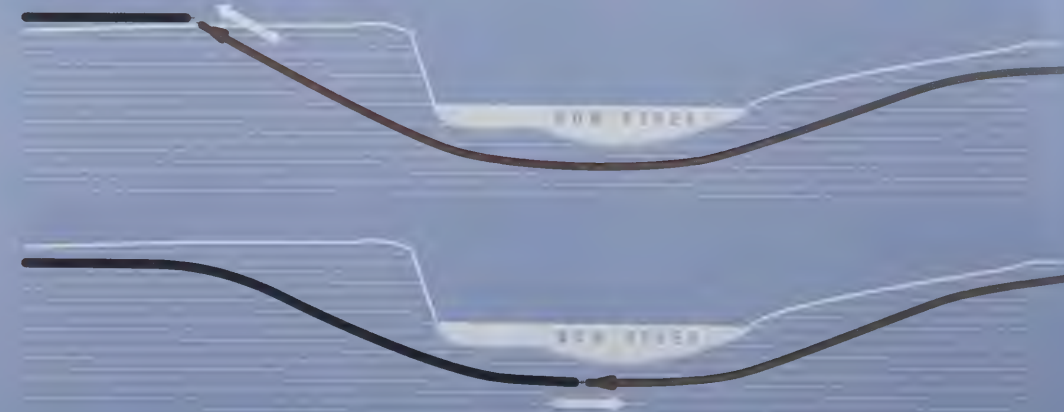
The pipeline was installed at a depth of 50 metres below the riverbed. The pipeline was installed at a depth of 50 metres below the riverbed.

The pipeline was installed at a depth of 50 metres below the riverbed. The pipeline was installed at a depth of 50 metres below the riverbed.

Directional drilling was originally used in Texas more than 30 years ago to access deposits of oil offshore from rigs. Today directional drilling is used to cross rivers as large as the St. Lawrence and Mississippi. To begin directional drill, a boring tool is guided through the ground using the latest tracking technology; a locator uses a receiver which indicates the exact position in which to drill a pilot hole. On the opposite bank, pre-welded pipe is readied for the operation. When the crossing has been drilled, the pipe is attached to the boring tool and pulled back through the excavation.

As soon as the route for the Southbound Expansion was finalized, a team of geologists, environmentalists and engineers determined the exact spot to cross the river. To do this, geologists studied bore samples looking for a base of solid bedrock to provide a protective layering for the pipeline.

Below: A directional drill tool is inserted into the ground from one side of the river. A receiver is attached to the tool and pulled back through the excavation.



The pipeline was installed at a depth of 50 metres below the riverbed. The pipeline was installed at a depth of 50 metres below the riverbed.



A member of the construction crew attends a training session every morning, held at a nearby site. A classroom across the street affords the convenience of the construction route.

### Planning to go unnoticed

A team of environmental, geological, engineering, construction and drilling experts mobilized to plan the construction and execute it as inconspicuously as possible. For the most part, the expansion would follow Koch's current corridor, where two 8" pipelines were buried. Because this corridor had been created decades ago however, a thorough field reconnaissance was conducted to determine the optimum routing for the expansion.

Environmental and archaeological consultants scouted the proposed route and identified areas of special historical or biological significance. Meanwhile Koch, in consultation with local communities, the Eastern Irrigation District (the largest landowner on the Hays portion of the expansion), the Bow River Irrigation District and other landowners, established the timing and final route.

The Eastern Irrigation District had recently implemented new regulations restricting construction to a narrow window in the months of April and May — just after spring break up but before the

development of new grass. This timing ensured that construction dust didn't settle and choke the new shoots.

According to Glen Brown of the Bow River Irrigation District, Koch went the extra mile in planning the project. "In one area, where Koch's planned route crossed an irrigated pasture, they decided to bore under the pasture. This avoided disturbing the area altogether. They didn't have to do that, but we were very impressed they did."

Recovery takes on the low surrounding 8" pipelines from the construction corridor of the new 40" expansion in the distance.



**Tailgate Safety Meeting:** Prior to construction, all contractors attended a kick-off meeting where they received a thorough safety and environmental briefing. Koch is determined to construct all pipelines safely, and to the finest quality.

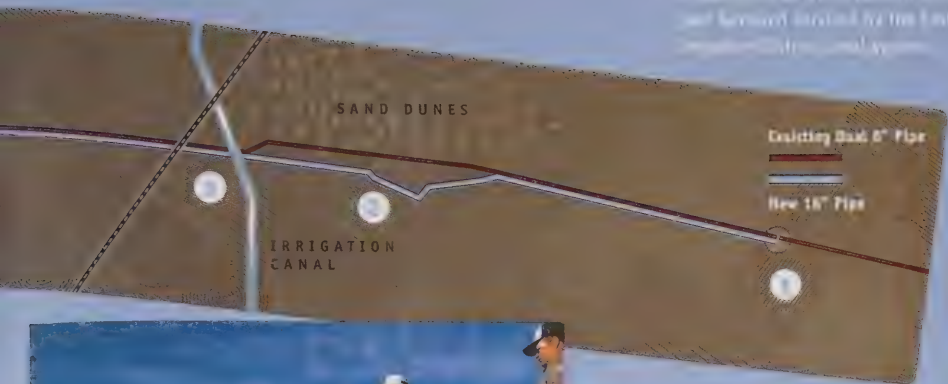


Over the past decade, as the oil producing regions in the United States have matured, demand has increased for Canadian crude. Several years ago the Koch team identified an opportunity for the Partnership to economically expand the Bow River Pipeline System and carry additional product south to Montana refineries.

The Partnership developed a strategy to expand the Bow River Pipeline System in stages starting with the Princess Reconfiguration in 1999, which increased capacity by 22,000 barrels per day. In 2001, Koch tied in significant new production from the Jenner and Suffield areas, with the construction of the Suffield pipeline and a 15,000 barrel-per-day capacity expansion of the Jenner lateral. In July 2001, the Partnership completed

the most recent phase of the expansion program: the construction of the Hays and Warner Loops, expanding capacity by 25,000 to 118,000 barrels per day.

"In expanding the Bow River Pipeline System we saw a great opportunity to capture significant value for our unitholders through a relatively small investment," said David Fesyk, Koch's President and Chief Executive Officer, adding that Koch anticipates future expansions to this system. "Because Koch is in this business for the long haul, we recognize how important it is to grow in a way that is cognisant of our landowners. Since we value our relationships with our neighbours, we are pleased to work with them to ensure our projects are completed as discreetly as possible."



1. Location of the new pipeline is determined by the need to build a new line to the east of the existing line.



2. The project is a joint venture between the state and private companies.

3. The quality of the construction is the responsibility of the contractor, who is also responsible for the safety of the project.



4. The project is a joint venture between the state and private companies.

5. The project is a joint venture between the state and private companies.



"Thanks to a combination of good planning, teamwork and state-of-the-art technology, Koch completed the drilling in 20 days without any lingering effect on the environment."

—Koch Industries

—Koch Industries



6. The project is a joint venture between the state and private companies.

7. The project is a joint venture between the state and private companies.



8. The project is a joint venture between the state and private companies.



LEFT To avoid disturbing the corner of an irrigation canal, hydroponic systems were placed from above the trees and a tunnel.

BELOW The objective of the pipeline was to avoid the impact of the natural environment by the use of the natural environment. The pipeline was built to avoid the impact of the natural environment.

### Mountains of pipe

Safety on the construction site was of paramount concern. Every morning, at a mandatory tailgate safety meeting, workers were reminded about the project's safety rules and regulations.

"We were constructing in a dry period and the drought in southern Alberta made conditions even worse," Allan Ross, the Project Manager explained. "There was no smoking allowed on the right-of-way, and spotters and water trucks were on constant alert in case a stray welder's spark accidentally ignited the dry grass."

As well as the safety of the workers on the construction site, Koch's engineers were vigilant at ensuring that the new pipeline would remain safe and operational for decades. Crews were careful to inspect every inch of pipe before it went into the ground to verify that the coating, which protects from soil moisture and slows corrosion, was intact.

The excavations were done with equal care. While excavating, soil-conservation practices were used where crews separated each layer of soil and ensured that the trenches were refilled in the same order. By doing this they made certain that the indigenous plants would re-root and grow naturally over the right-of-way. Where there were no other utilities or pipelines in the area, bulldozers and ditchers moved in and created a trench for the pipeline bed. When other utilities or pipelines were encountered however, excavations were done by hand to ensure nothing was disturbed or ruptured by the activity.

On the heels of the excavation crew, crane operators would lay a long ribbon of pipe and get it ready for welding. Once the pipe was fitted together, a team of welders moved in. The welded pipe was then lifted in massive sections and gently lowered into the trench. Then, before the trench was refilled, the pipe was given a final inspection to ensure its integrity.



"Koch is open to a different way of thinking. They were very sensitive to our needs and they always prefer to come to a consensus. They're great people to work with."

*Glen Brown, Chairman, Brown & Caldwell*



## Distributions to unitholders increased in 2001.

The Partnership paid unitholders in 2001 a total of \$49.8 million, or \$0.68 per unit, an increase of \$1.5 million, or \$0.02 per unit, over the previous year. Cash flow from operations totaled \$51.9 million, in line with the previous year. Strong business performance enabled the Partnership to set aside \$1.1 million in a reserve to fund future distributions and/or capital and maintenance projects. This compares to the previous year where a total of \$3.3 million was placed in this reserve for future distributions and capital and maintenance projects such as the tank upgrade program.

### Results from Operations

Throughput volumes averaged 235,000 barrels per day in 2001, 5% lower than the previous year. In 2001, increased production from the Suffield region was off-set by natural field declines. In addition, rationalization of under-performing assets eliminated low revenue volumes.

Pipeline throughputs are influenced by new drilling and development activities that off-set natural field declines. During the year, the Partnership experienced lower levels

# Management's Discussion & Analysis

of drilling activity in its service corridors in response to lower oil prices and wider light-to-heavy crude oil price differentials. In 2001, the Bow River stream netback price averaged \$25.16 per barrel compared to \$34.56 in the prior year. In December, in response to continuing low net-back prices, producers deferred well servicing activity and shut in wells.

Drilling activity on the Bow River Pipeline System was concentrated within the Canadian Forces Base at Suffield, Alberta. Volumes from this region grew by approximately 5,000 barrels per day over the previous year. However, volume throughputs were affected by management's decision in October to suspend operations at the under-performing Hardisty truck terminal eliminating 7,500 barrels per day. This was a major factor in the fourth quarter reduction in volumes when compared to the previous quarter.

For 2002, we anticipate drilling activity will be stimulated by a gradual recovery in the demand for the heavier grades of crude oil. The first signs of a recovery are evident with the current narrowing of light-to-heavy crude oil price differentials. This is expected to lead first to producers increasing oil well servicing activity and reactivating shut-in wells then, to an increase in drilling activity in Koch's service corridors by the second half of 2002.

**AVERAGE DAILY THROUGHPUT***(thousands of barrels per day)*

	2001	2000	1999	1998	1997
<b>Bow River Pipeline System:</b>					
Bow River crude oil	131.4	140.4	141.8	157.6	165.2
Light sour crude oil	23.7	19.9	20.2	25.0	27.4
Pipeline system total	155.1	160.3	162.0	182.6	192.6
<b>Koch Alberta Pipeline System:</b>					
Light sour crude oil	36.4	43.1	37.4	47.2	60.0
Light sweet crude oil	—	—	1.3	2.9	3.5
Pipeline system total	36.4	43.1	38.7	50.1	63.5
<b>Mid-Saskatchewan Pipeline System:</b>					
Heavy blend crude oil	26.4	27.8	25.0	31.2	29.7
Light sweet crude oil	10.6	10.1	10.5	12.6	13.4
Pipeline system total	37.0	37.9	35.5	43.8	43.1
<b>Koch Valley Pipeline System:</b>					
Condensate	6.5	6.9	7.5	6.4	7.2
<b>Total Pipeline Systems:</b>	<b>235.0</b>	<b>248.2</b>	<b>243.7</b>	<b>282.9</b>	<b>306.4</b>

The 11% growth in revenue was a major contributor to the \$0.02 increase in annual distributions to \$0.68 per unit. Revenue in 2001 was \$92.1 million compared to the previous year of \$83.1 million. Average revenue per barrel increased from \$0.92 to \$1.07 per barrel.

A variety of factors contributed to the growth in revenue per barrel ranging from toll increases to off-set higher operating expenses to changes in volume receipt and delivery patterns. In January 2001 mainline tolls were increased to compensate for higher costs relating to power and asset integrity programs. Volume growth on high revenue laterals, such as Jenner and Suffield, off-set the loss of low revenue volumes at locations such as the Hardisty Truck Terminal where operations were suspended. In July, the Partnership transported a record 101,700 barrels per day south to Milk River. The pipeline generates incremental revenue of \$0.34 per barrel on Bow River southbound volumes as compared to northbound volumes.

Revenue per barrel for 2002 is expected to average approximately \$1.16, in line with the level achieved in the second half of 2001. At the end of 2001, the temporary G-55 toll surcharge of approximately \$0.05 per barrel expired on the Partnership's Alberta pipelines. This surcharge was introduced in July 1999 to pay for the costs associated with the Partnership's tank upgrade program. The impact of this lost revenue is expected to be off-set by toll increases introduced across the Partnership's gathering pipeline segments, effective January 1, 2002. These toll increases reflect pipeline usage and have been structured to cover the costs associated with proactive asset integrity programs scheduled for 2002 and beyond.

Operating expenses were \$34.0 million for 2001 compared to \$25.6 million the previous year. The increase was in line with expectations and was driven by higher power costs and increased spending on proactive asset integrity programs. Power costs are the Partnership's largest operating expense. At the beginning of 2001, power prices increased

dramatically in response to power supply shortages experienced across Alberta. To reduce the impact of volatile power prices on future distributions, approximately two-thirds of the year's power consumption was hedged at a fixed price. Hedging losses of \$2.1 million on the fixed-price power hedge were offset by toll increases that came into effect January 1, 2001.

The Partnership believes proactive asset integrity spending such as regular pipeline inspection and repair will preserve the life of the pipelines and result in lower operating costs over the medium to long-term. During the year, 64,000 barrels of storage capacity was upgraded to meet the pipelines' current storage requirements and to comply with Alberta's new regulatory requirements, effective October 31, 2001. The Partnership also incurred \$1.2 million to repair and remediate a leak on the Jenner lateral.

Operating expenses in 2002 are expected to benefit from lower power costs and the completion of the Alberta tank-upgrade program. However, total 2002 operating expenses are expected to remain in line with 2001 due to continuing asset integrity programs and industry-wide increases in insurance premiums. In the coming year, the Partnership will continue its ongoing pipeline inspection program. In previous years, the majority of pipeline inspection and repair expenditures have been funded under a \$10 million pipeline inspection and repair program funded by KPG Canada Ltd. and its Canadian affiliates ("Koch Canada"). This program will come to a close in 2002 and future pipeline inspection and repair costs will be borne directly by the Partnership.

General and administrative expenses increased from \$3.8 million in 2000 to \$4.0 million in 2001. This increase was due to expenses of \$0.4 million incurred in pursuing acquisition opportunities that did not materialize.

Depreciation expense for 2001 of \$40.3 million compares to \$42.5 million in 2000. Capital assets are depreciated on a declining balance basis over the estimated service life, commencing when the assets are placed in service. The estimated service life of pipeline assets is determined with reference, together with other factors, to the estimated remaining commercial life of the crude oil reserves expected to be gathered on the particular pipeline systems. The Partnership's pipeline and pumping assets have service lives which typically range from 15 to 25 years.

The management fee of \$1.1 million was in line with the previous year. Koch Pipelines Canada Ltd. (the "General Partner") is paid 2% of 'Operating Cash' as defined in the Partnership Agreement.

In 2001, the Partnership generated net income of \$8.2 million, or \$0.11 per unit, which was in line with the \$8.8 million, or \$0.12 per unit, earned a year earlier.

#### **Koch Canada-funded capital and pipeline inspection expenditures**

There is a distinction between capital and pipeline inspection projects funded by the Partnership and those funded by Koch Canada. When the Partnership's assets were acquired from the General Partner on November 27, 1997, certain capital improvements and a pipeline inspection and repair program were ongoing. The estimated cost of

these projects was \$20 million and \$10 million respectively. In conjunction with the sale of the pipeline assets, the Partnership paid \$30 million to an affiliate of the General Partner to complete these projects on the Partnership's behalf. All cash outlays related to the capital improvements program are for the account of Koch Canada. Under the pipeline inspection and repair program, Koch Canada is responsible for all costs and cash outlays up to \$10 million. The capital improvement program costs are being capitalized and the pipeline inspection and repair costs are being expensed as the expenditures are incurred.

During 2001, approximately 255 kilometres of pipeline were inspected and repaired under the \$10 million pipeline and inspection program at a cost of \$3.8 million. Approximately \$1.3 million remains of the original \$10 million prepaid balance.

The replacement of a 22 kilometre pipeline segment between Hussar and Drumheller on the Koch Alberta Pipeline System, scheduled for completion by the fall of 2002, remains the only outstanding project under the Koch Canada-funded \$20-million capital improvements program.

#### Partnership-funded capital expenditures

Capital expenditures for 2001 totalled \$22.6 million, of which \$19.3 million was invested to expand the Bow River Pipeline System.

In response to increased production from the Suffield area the Partnership completed two expansions on the Bow River Pipeline System. In February, shipments commenced on the \$4.9 million, 7,500 barrel-per-day pipeline lateral from the Bow River mainline, east to the southwestern section of the Canadian Forces Base at Suffield, Alberta. In July, the 15,000 barrel-per-day expansion of the Jenner lateral was finalized. This lateral expansion provides service to the northwestern area of the Suffield Canadian Forces Base. In support of the expansion the major producers in the area committed to a five-year shipping agreement.

In July, 2001, the 25,000 barrel-per-day southbound capacity expansion of the Bow River Pipeline System was completed. The Partnership is now capable of transporting 118,000 barrels per day south to the growing Montana refining market. This \$14.4 million expansion strengthens our position as the primary long-term supplier to this market and is supported by long-term shipping agreements with several Bow River shippers.

#### Cold Lake Pipeline Limited Partnership

The Partnership holds a 15% share in the Cold Lake Pipeline Limited Partnership which owns the major heavy oil transportation system in the Cold Lake region of east-central Alberta. AEC Pipelines, L.P. ("AEC") and Canadian Natural Resources Limited respectively hold a 70% and 15% interest in the limited partnership.

In exchange for its 70% interest in the Cold Lake Pipeline Limited Partnership, AEC contributed its existing Cold Lake Pipeline which transports crude oil between LaCorey and Edmonton, Alberta and its Foster Creek extension that gathers oil in the Foster Creek area. On December 21, 2001, the Cold Lake Pipeline Limited Partnership started shipping on the newly constructed 235 kilometre, 24-inch blend transmission

pipeline between LaCorey and Hardisty, Alberta. Initially, these combined assets will provide heavy oil shipping capacity of approximately 430,000 barrels per day.

The Partnership's total contribution to the Cold Lake Pipeline Limited Partnership to date has been \$48.7 million. This consists of an initial investment of \$41.7 million and its share of the Foster Creek extension costs of \$7 million. In 2002, a further \$1.7 million will be contributed.

Upon completion of the LaCorey-to-Hardisty leg, on December 21, 2001, Koch Pipelines started sharing in the profits of the Cold Lake Pipeline Limited Partnership. For the ten days of operation in 2001, the Partnership's share of the Cold Lake Pipeline Limited Partnership's net profit was \$0.3 million.

### Liquidity and capital resources

At December 31, 2001 Koch had debt outstanding of \$86.2 million which equates to a ratio of debt to cash flow from operations of 1.7 times. Debt levels will continue to be managed prudently to maintain the Partnership's ability to act quickly as growth opportunities arise. Undistributed cash flow from operations will be applied to a combination of future debt reduction, capital and maintenance projects and/or distributions.

The Partnership has in place committed loan facilities with two Canadian banks totaling \$125 million. The facilities consist of a \$75 million unsecured revolving facility and a \$50 million unsecured non-revolving reducing facility. The \$50 million loan facility is due for repayment by December 14, 2003.

Koch has invested a total of approximately \$65 million over the past 18 months in the Cold Lake Pipeline Limited Partnership and the Bow River Southbound Expansion. The cash flow streams from both investments are supported by long-term shipping agreements. To minimize the impact of volatile interest rates on the financial returns from the investments, the Partnership entered into three fixed-paying interest rate swaps totaling \$65 million. The maturity terms of the swaps match the terms of the long-term shipping agreements.

In 2001, the Partnership incurred total interest charges of \$1.6 million of which \$0.6 million was capitalized and \$1.0 million was expensed, compared to \$0.4 million expensed a year earlier. This was due to an increase in net debt of \$69.2 million to fund the capital investments over the past year.

### Outlook

In 2002, the Partnership expects to maintain its record of stable distributions as a result of improved asset profitability and the cash flow contributions from recent investments, including the Cold Lake Pipeline Limited Partnership. However, it is not easy to forecast if the recent recovery in producer wellhead netback prices will translate into higher volume throughputs.

In 2002, the Cold Lake Pipeline Limited Partnership is expected to contribute \$6.2 million to Koch's cash flow. In addition, in February 2002, the Partnership successfully received pipeline capacity commitments to support the extension of the southbound capability of the Bow River Pipeline System. This \$14 million investment will allow Koch to transport 9,200 barrels per day from Hardisty to Princess, commencing in the second half of 2002.

### Business risks

The Partnership's goal is to maintain stable distributions while pursuing growth opportunities that will enhance cash distributions to the unitholders. However, a number of inherent risks exist that may cause fluctuations in the Partnership's distributions.

Future throughput and replacement of crude oil reserves will be dependent upon the success of producers to develop existing reserves, and to identify and produce additional reserves, in the Partnership's service corridors. Without such developments, the volumes of crude oil transported through the pipelines will decline over time as reserves are depleted. Crude oil production is also a function of crude oil prices, and sustained lower prices may result in additional production declines due to fewer wells being drilled, reduced well maintenance and possibly deliberate shut-ins. In most instances, the Partnership does not have long-term ship-or-pay contracts with producers in its service areas. Therefore, if production declines due to depletion of resources, low crude oil prices or other factors, producers are not required to ship specific volumes of crude oil on the Partnership's pipeline systems and volumes and revenues on the systems may decline. The pipelines are subject to competition for volumes transported by truck to other pipelines near the areas serviced by the Partnership's pipelines. While competing pipelines could be constructed in areas served by the Partnership, we are not aware of any current plans to do so.

The Partnership's operations are subject to the customary hazards of the crude oil transportation business. Its operations could be interrupted by failures of pipelines, pumps and equipment, or natural disasters or other events beyond the Partnership's control. Crude oil pipelines have historically had the best safety record in the North American hydrocarbon transportation industry. The principal risks associated with crude oil pipelines are the property damage and cleanup expenses incurred by unintended discharges, or increased obligations imposed by new or revised regulations. The Partnership undertakes a number of preventative initiatives to promote safe and efficient operation and to mitigate the risk of loss from pipeline leaks and crude oil spills. Also, the Partnership carries insurance that provides coverage for business interruption and sudden and accidental discharges under certain circumstances.

## Management's Responsibility for Financial Statements

The accompanying financial statements of Koch Pipelines Canada, L.P. (the "Partnership") and all information in this Annual Report are the responsibility of the management of the General Partner, Koch Pipelines Canada Ltd., and have been approved by the Board of Directors of Koch Pipelines Canada Ltd., on behalf of the Partnership. The financial statements have been prepared by the General Partner in accordance with Canadian generally accepted accounting principles and include certain estimates that reflect the General Partner's best judgements. Financial information contained throughout this Annual Report is consistent with these financial statements.

The General Partner has developed and maintains an extensive system of internal controls that provides reasonable assurance that all Partnership transactions are accurately recorded, that the Partnership's financial statements realistically report the operating and financial results and that the Partnership's assets are safeguarded.

In accordance with the Partnership Agreement, Ernst & Young LLP, an independent firm of chartered accountants, was appointed by the General Partner to audit the Partnership's financial statements and provide an independent audit opinion.

Koch Pipelines Canada Ltd. ("General Partner"), on behalf of Koch Pipelines Canada, L.P.



DAVID W. FESYK  
*President and Chief Executive Officer*



SCOTT D. GERLA, C.A.  
*Vice President, Finance*

# Financial Statements

## Auditor's Report


To the Partners of Koch Pipelines Canada, L.P.

We have audited the balance sheets of Koch Pipelines Canada, L.P. (the "Partnership") as at December 31, 2001 and 2000 and the statements of partners' equity, operations and distributable cash, and cash flows for the years then ended. These financial statements are the responsibility of the management of Koch Pipelines Canada Ltd. (the "General Partner") on behalf of the Partnership. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of the Partnership as at December 31, 2001 and 2000 and the results of its operations and its cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Calgary, Canada  
January 25, 2002



CHARTERED ACCOUNTANTS

As at December 31 (thousands of dollars)

	2001	2000
<b>ASSETS</b>		
<b>Current</b>		
Cash	\$ 18,038	\$ -
Accounts receivable [note 8]	11,367	23,718
Prepaid expenses	792	347
	30,197	24,065
Deferred capital and pipeline inspection expenditures [note 3]	2,398	6,155
Investment in Cold Lake Pipeline Limited Partnership [note 4]	50,289	2,338
Capital assets [note 5]	534,324	552,070
	<b>\$ 617,208</b>	<b>\$ 584,628</b>

**LIABILITIES AND PARTNERS' EQUITY**

<b>Current</b>		
Bank indebtedness	\$ -	\$ 373
Distributable Cash payable [notes 6 and 8]	12,444	12,444
Accounts payable and accrued liabilities [note 8]	10,479	22,081
	22,923	34,898
Bank loans [note 7]	86,180	-
	109,103	34,898
Partners' equity	508,105	549,730
	<b>\$ 617,208</b>	<b>\$ 584,628</b>

**Commitments and Contingencies [notes 4, 7 and 9]**

See accompanying notes

On behalf of the Board of Koch Pipelines Canada Ltd.,  
as General Partner of the Partnership:



Director



Director

STATEMENTS OF  
PARTNERS' EQUITY

Years ended December 31

(thousands of dollars, except for units)

	<i>Class A Limited Partnership Units</i>	<i>Class B General Partner Units</i>	<i>Total</i>
Partners' equity, December 31, 1999	\$ 301,879	\$ 287,388	\$ 589,267
Net income for the year	4,495	4,280	8,775
Distributions	(24,750)	(23,562)	(48,312)
<b>Partners' equity, December 31, 2000</b>	<b>281,624</b>	<b>268,106</b>	<b>549,730</b>
Net income for the year	4,176	3,975	8,151
Distributions	(25,500)	(24,276)	(49,776)
<b>Partners' equity, December 31, 2001</b>	<b>\$ 260,300</b>	<b>\$ 247,805</b>	<b>\$ 508,105</b>

Number of units outstanding [note 6]:

<b>December 31, 2001 and 2000</b>	<b>37,500,000</b>	<b>35,700,000</b>	<b>73,200,000</b>
-----------------------------------	-------------------	-------------------	-------------------

See accompanying notes

## STATEMENTS OF OPERATIONS AND DISTRIBUTABLE CASH

Years ended December 31 (thousands of dollars, except per unit amounts)

	<i>2001</i>	<i>2000</i>
<b>REVENUE</b>	<b>\$ 92,050</b>	<b>\$ 83,133</b>
<b>EXPENSES</b>		
Operating	33,999	25,614
General and administrative	4,045	3,750
Pipeline inspection expenditures [note 3]	3,757	1,008
	<b>41,801</b>	<b>30,372</b>
<b>Income before the following</b>	<b>50,249</b>	<b>52,761</b>
Equity income [note 4]	323	-
Depreciation	(40,345)	(42,510)
Management fees [note 1]	(1,115)	(1,106)
Interest expense	(961)	(370)
<b>Net income</b>	<b>8,151</b>	<b>8,775</b>
<b>Add (deduct)</b>		
Depreciation	40,345	42,510
Deferred capital and pipeline inspection expenditures [note 3]	3,757	1,385
Proceeds on sale of capital assets	47	403
Loss (gain) on sale of capital assets	3	(10)
Equity income [note 4]	(323)	-
Investment in Cold Lake Pipeline Limited Partnership [note 4]	(47,628)	(2,338)
Financing related to investment in Cold Lake Pipeline Limited Partnership	47,628	2,338
Capital expenditures incurred	(22,649)	(5,819)
Net financing related to capital expenditures	21,544	4,320
Reserve to be used for capital and maintenance projects and future distributions	(1,099)	(3,252)
<b>Distributable Cash paid/payable</b>	<b>\$ 49,776</b>	<b>\$ 48,312</b>
<b>Per Partnership unit [note 6]</b>		
Net income	\$ 0.11	\$ 0.12
Distributable Cash paid/payable	\$ 0.68	\$ 0.66

See accompanying notes

**STATEMENT OF CASH FLOWS***Years ended December 31 (thousands of dollars)*

	<b>2001</b>	<b>2000</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 8,151	\$ 8,775
Equity income [note 4]	(323)	-
Depreciation	40,345	42,510
Reduction in deferred pipeline inspection expenditures	3,757	1,008
Loss (gain) on sale of capital assets	3	(10)
Cash flow from operations	51,933	52,283
Net change in non-cash working capital	954	40
<b>Cash provided by operating activities</b>	<b>52,887</b>	<b>52,323</b>
<b>INVESTING ACTIVITIES</b>		
Investment in Cold Lake Pipeline Limited Partnership	(47,628)	(2,338)
Additions to capital assets	(23,299)	(5,442)
Proceeds on sale of capital assets	47	403
<b>Cash used in investing activities</b>	<b>(70,880)</b>	<b>(7,377)</b>
<b>FINANCING ACTIVITIES</b>		
Distributable Cash paid	(49,776)	(47,580)
Increase (decrease) in bank loans	86,180	(8,850)
<b>Cash provided by (used in) financing activities</b>	<b>36,404</b>	<b>(56,430)</b>
<b>Increase (decrease) in cash during the year</b>	<b>18,411</b>	<b>(11,484)</b>
(Bank indebtedness) cash, beginning of year	(373)	11,111
<b>Cash (bank indebtedness), end of year</b>	<b>\$ 18,038</b>	<b>\$ (373)</b>

*See accompanying notes*

## Notes to Financial Statements

December 31, 2001 and 2000

(tabular amounts in thousands of dollars)

### 1. Structure of the Partnership

The Partnership was formed as a limited partnership under the laws of Alberta pursuant to an agreement dated October 9, 1997 (the "Partnership Agreement"). Koch Pipelines Canada Ltd. is the General Partner. On November 27, 1997 the Partnership acquired its pipeline assets from the General Partner for cash and 35,700,000 Class B units in the partnership. At the same time the Partnership sold 37,500,000 Class A units to the public.

The Partnership's business activities are related to the transportation, storage, marketing, and processing of hydrocarbons in Canada.

The Partnership is dependent on the General Partner for the administration and management of all matters relating to the operation of the Partnership.

Under the Partnership Agreement, the General Partner is entitled to recover all direct and indirect expenses, including general and administrative expenses, incurred on behalf of the Partnership. The General Partner also receives an annual base fee equal to 2% of the Partnership's annual "Operating Cash" as defined in the Partnership Agreement. In addition, the General Partner is entitled to earn an annual incentive fee of between 15% and 35% of the Partnership's annual Distributable Cash in excess of \$1.01 per unit to \$1.19 per unit respectively; an acquisition fee of 1.0% of the purchase price of any assets acquired by the Partnership (excluding the pipeline assets originally acquired); and a disposition fee of 0.5% of the sale price of any assets sold by the Partnership.

The Partnership will distribute, on a quarterly basis, Distributable Cash to holders of the Class A and B Partnership units (collectively the "Partnership Units"). Distributable Cash is defined in the Partnership Agreement and generally means net income of the Partnership, adjusted for non-cash items and further adjusted for certain reserves, and is intended to allow the Partnership to retain cash as required to meet its ongoing liquidity and capital requirements.

Under existing tax legislation, the Partnership is not subject to income taxes directly. The limited partners and General Partner are subject to tax on their proportionate interests of the taxable income allocated by the Partnership.

## Summary of Significant Accounting Policies

### Capital assets

Expenditures for system expansion and betterments are capitalized; maintenance and repair costs are expensed as incurred. Depreciation of pipeline facilities and equipment commences when the pipelines are placed in commercial operation and is provided on a declining balance basis over their estimated service lives which range from 15 to 25 years. The service life for pipeline systems is determined with reference, together with other factors, to the estimated remaining life of the crude oil reserves expected to be gathered on the particular pipeline systems. Costs related to construction in progress are not depreciated until the asset commences commercial operations.

### Future site restoration and abandonment costs

Pipeline operations will be charged with any costs associated with the future site restoration and abandonment of the pipeline assets. The potential costs of abandonment will be a function of several factors, including regulatory requirements at the time of abandonment, the size of the pipeline and the pipeline's location. Abandonment requirements can vary considerably, ranging from emptying the pipeline to removal of the pipeline and reclamation of the right-of-way. It is expected that portions of the pipeline assets will be abandoned over time, and the costs of smaller abandonments, not expected to be material in any particular year, will be charged to operating expense in the year of abandonment. At such time as the cost of abandoning substantial portions of the pipeline assets can reasonably be determined, estimated costs will be provided over the remaining life of the pipeline assets. To date, no provision for such future costs has been recorded.

### Measurement uncertainty

The amounts recorded for depreciation of capital assets and the projections of future site restoration and abandonment costs are based on estimates. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future years could be significant.

### Investment in Cold Lake Pipeline Limited Partnership

The investment in Cold Lake Pipeline Limited Partnership ("Cold Lake") is accounted for using the equity method as the Partnership has significant influence over the strategic decisions, but does not have the ability to exercise joint control. Under the equity method, the carrying value of the Partnership's investment in Cold Lake is increased by incremental capital contributions and the Partnership's equity interest in the income and reduced by the distributions declared by Cold Lake and the Partnership's equity interest in the losses.

The carrying value of the investment in Cold Lake is lower than the estimated net realizable value.

### Financial instruments

Financial instruments of the Partnership consist of cash, accounts receivable, bank indebtedness, Distributable Cash payable, accounts payable and accrued liabilities and bank loans. There are no material differences between the carrying amounts of these financial instruments reported on the balance sheet and their estimated fair values.

The Partnership utilizes derivative financial instruments to manage its exposure to changes in interest rates and power costs. The gain or loss incurred on these instruments is recognized in income in the same period as the hedged transactions are settled.

## 3. Interest Capital and Pipeline Inspection Expenditures

	2001	2000
Capital expenditures	\$ 1,127	\$ 1,127
Pipeline inspection expenditures	1,271	5,028
	\$ 2,398	\$ 6,155

On November 27, 1997 certain capital expenditures and a pipeline inspection and repair program were ongoing with respect to the assets acquired from the General Partner. The estimated costs of these two projects were \$20 million and \$10 million, respectively. Concurrent with the sale of the pipeline assets to the Partnership, the Partnership paid \$30 million to an affiliate of the General Partner to complete the programs on the Partnership's behalf. The capital expenditures are capitalized to pipeline facilities and equipment and the inspection and repair costs are charged to expense when the expenditures are made by the affiliate with no cash outlay by the Partnership.

## 4. Investment in Cold Lake Pipeline Limited Partnership

	2001	2000
Capital contributions	\$ 48,709	\$ 1,710
Capitalized interest	635	6
Other capital expenditures	622	622
Equity income	323	—
	\$ 50,289	\$ 2,338

On October 5, 2000 the Partnership entered into the Cold Lake Pipeline Limited Partnership Agreement ("Cold Lake Agreement"). At that time the Partnership committed to contribute initial capital to the Cold Lake Pipeline Limited Partnership ("Cold Lake") of approximately \$50 million by April 2002, of which \$1.7 million remains to be contributed at December 31, 2001. These contributions represent 15% of the fair value of the total initial capital to be contributed by all partners. Cold Lake commenced commercial operations on December 21, 2001.

Cold Lake has entered into long term Transportation Service Agreements with four initial founding shippers concurrent with the Cold Lake Agreement.

## 5. Tangible Assets

	2001	2000
Pipeline facilities and equipment	\$ 709,861	\$ 686,672
Construction in progress	5,435	6,025
	715,296	692,697
Accumulated amortization	(180,972)	(140,627)
	\$ 534,324	\$ 552,070

## 6 Net Income and Distributable Cash

Partnership units share equally on a pro rata basis in the allocation of net income and Distributable Cash. The amount reported for net income and Distributable Cash per unit is based on the weighted average number of units outstanding for the year of 73,200,000 (2000 – 73,200,000). The Partnership does not have a unit options plan.

## 7 Bank Loans

The Partnership has a committed \$75 million unsecured revolving credit and term loan facility with a Canadian chartered bank. As at December 31, 2001, \$36.2 million was borrowed under the facility (2000 – nil). The facility is fully revolving for 364 day periods with provision for extensions at the option of the lender following notice from the Partnership. If not extended, the facility converts to a non-revolving reducing facility to be repayable in full by the end of two years.

The Partnership has a committed \$50 million unsecured non-revolving reducing credit and term loan facility with a Canadian chartered bank, which was fully drawn at December 31, 2001 (2000 – nil). The facility is to be repaid in full by December 14, 2003.

The applicable interest rates on bank loans outstanding at December 31, 2001 range from 2.1% on bankers' acceptances to 4.0% on prime based loans. Cash interest paid during the year was \$1.4 million (2000 – \$0.4 million).

The Partnership has entered into interest rate swap agreements totaling \$65 million with a Canadian chartered bank to reduce the interest rate exposure associated with the Cold Lake Pipeline Limited Partnership investment (note 4) and the Bow River Pipeline Southbound Expansion. Effective September 30, 2001, the interest rate on \$15 million became fixed at 5.41% for five years. Effective December 31, 2001 and for ten years thereafter, the interest rate on \$15 million has been fixed at 6.31%. The interest rate on the remaining \$35 million has been fixed effective December 31, 2001 for 10 years at 6.30%, with the notional principal being reduced by \$1 million per annum. The fair market value of the outstanding swap contracts as at December 31, 2001 results in an unrecognized loss of \$3.3 million.

At December 31, 2001 the Partnership has issued and outstanding letters of credit in the amount of \$0.8 million (2000 – \$1.7 million).

## 8. Related Party Transactions

Revenue includes \$1.0 million (2000 - \$2.2 million) earned from affiliates of the General Partner in the normal course of operations. These amounts are recorded at their exchange amounts.

Operating and general and administrative expenses include direct costs incurred by affiliates of the General Partner on the Partnership's behalf and an allocation of operating and general and administrative expenses from those affiliates based primarily on time spent on the activities associated with Partnership operations. Such amounts are incurred in the normal course of operations and are recorded at an estimate of the cost for such expenses.

Amounts due from/to the General Partner and its affiliates are non-interest bearing and have no fixed repayment terms. At December 31, 2001, amounts payable between the Partnership and affiliates of the General Partner include \$0.5 million (2000 - \$4.2 million) in accounts receivable and \$4.5 million (2000 - \$12.8 million) in accounts payable and accrued liabilities. Included in Distributable Cash payable is \$6.1 million (2000 - \$6.1 million) payable to the General Partner due to the ownership of the Class B units.

One member of the Board of Directors was paid \$32,400 (2000 - nil) for consulting services provided to the Partnership. These amounts are in the normal course of operations and recorded at their exchange amounts.

## 9. Contingencies

The Partnership is named as a party to legal claims associated with its normal course of business. In management's opinion, the resolution of these claims is not expected to have a material impact on the operations or financial position.

## 10. Risk Management

### Credit Risk Management

Credit exposure on financial instruments, which consisted of interest rate swaps, arises from the possibility that a counter-party in which the Partnership has an unrealized gain fails to perform according to the terms of the contract. The Partnership believes the risks of non-performance are minimal as the counter-parties are major financial institutions.

### Energy Prices

During 2001, the Partnership used derivatives to manage the price risk associated with the purchase of its power supply. Operating expenses for the year ended December 31, 2001 include losses of \$2.1 million (2000 - nil) associated with such contracts. The energy price derivative expired on December 31, 2001.

## 11. Major Customers

In 2001, one customer accounted for 10% (2000 - 11%) of the revenue of the Partnership.

## Unitholders' tax allocation

For 2001 operations, the Partnership declared and paid cash distributions totaling \$0.68 per unit. The 2001 taxable income amounts to approximately 36.32% of the total cash distributions. The remaining 63.68% is considered a tax-deferred return of capital.

The following information is provided to assist Partnership unitholders in preparing their income tax returns; however, this information is of a general nature only and is not intended to be legal or tax advice to any particular unitholder. We advise unitholders to seek professional advice.

**Partnership units held within an RRSP, RRIF or DPSP** No amounts are required to be reported for taxation purposes if the units are held within a RRSP (Registered Retirement Savings Plan), RRIF (Registered Retirement Income Fund), or DPSP (Deferred Profit Sharing Plan).

**Partnership units held outside an RRSP, RRIF or DPSP** Individual unitholders are taxable on their share of the Partnership's income for tax purposes. The amount of income allocated to a unitholder may be more or less than the amount of cash distributed to the unitholder during the year. For tax purposes, taxable income allocated to a unitholder will increase the carrying value of the cost base of the unitholder's investment in the Partnership.

**Adjusted cost base of partnership units** The adjusted cost base is used in calculating the capital gain or loss on the eventual disposition of the Partnership units held as capital property by the unitholder. When an individual unitholder disposes of their investment in the Partnership, a capital gain or loss may arise. A capital gain or loss is determined by subtracting the adjusted cost base of the Partnership units from the proceeds (net of selling commissions) of disposition.

To arrive at the adjusted cost base of the unitholder's investment in the Partnership, subtract the cumulative amount of all cash distributions received from the original cost of the investment (including any broker fees incurred on acquisition), then add the taxable income allocated and reported by the unitholder in the current and prior tax returns.

<i>Record Date</i>	<i>Payment Date</i>	<i>Cash Distributions (per unit)</i>	<i>Allocation of Income for Tax Purposes (per unit)</i>	<i>Return of Capital (per unit)</i>
December 31, 1997	January 30, 1998	\$ 0.07	\$ Nil	\$ 0.07
<b>Total 1997:</b>		<b>\$ 0.07</b>	<b>\$ Nil</b>	<b>\$ 0.07</b>
March 31, 1998	April 30, 1998	\$ 0.22	\$ 0.080	\$ 0.140
June 30, 1998	July 30, 1998	\$ 0.18	\$ 0.065	\$ 0.115
September 30, 1998	October 30, 1998	\$ 0.19	\$ 0.069	\$ 0.121
December 31, 1998	January 30, 1999	\$ 0.18	\$ 0.065	\$ 0.115
<b>Total 1998:</b>		<b>\$ 0.77</b>	<b>\$ 0.279</b>	<b>\$ 0.491</b>
March 31, 1999	April 30, 1999	\$ 0.16	\$ 0.053	\$ 0.107
June 30, 1999	July 30, 1999	\$ 0.16	\$ 0.053	\$ 0.107
September 30, 1999	October 30, 1999	\$ 0.16	\$ 0.053	\$ 0.107
December 31, 1999	January 31, 2000	\$ 0.16	\$ 0.053	\$ 0.107
<b>Total 1999:</b>		<b>\$ 0.64</b>	<b>\$ 0.212</b>	<b>\$ 0.428</b>
March 31, 2000	April 28, 2000	\$ 0.16	\$ 0.077	\$ 0.083
June 30, 2000	July 31, 2000	\$ 0.16	\$ 0.077	\$ 0.083
September 29, 2000	October 31, 2000	\$ 0.17	\$ 0.082	\$ 0.088
December 29, 2000	January 31, 2001	\$ 0.17	\$ 0.082	\$ 0.088
<b>Total 2000:</b>		<b>\$ 0.66</b>	<b>\$ 0.318</b>	<b>\$ 0.342</b>
March 30, 2001	April 30, 2001	\$ 0.17	\$ 0.062	\$ 0.108
June 29, 2001	July 31, 2001	\$ 0.17	\$ 0.062	\$ 0.108
September 28, 2001	October 31, 2001	\$ 0.17	\$ 0.062	\$ 0.108
December 31, 2001	January 31, 2002	\$ 0.17	\$ 0.062	\$ 0.108
<b>Total 2001:</b>		<b>\$ 0.68</b>	<b>\$ 0.248</b>	<b>\$ 0.432</b>
<b>Total:</b>		<b>\$ 2.82</b>	<b>\$ 1.057</b>	<b>\$ 1.763</b>

## Statement of Governance Practices

The following description of the governance practices of the Partnership and the General Partner is made with reference to the guidelines for effective corporate governance adopted by The Toronto Stock Exchange (the “TSE”). While the Partnership and the General Partner endorse the governance principles reflected in the TSE guidelines and consider good governance practices to be an important element in the effective and efficient operation of Canadian corporations, their respective approaches to governance are necessarily unique and do not strictly adhere to the TSE guidelines for a number of reasons, including the fact that the Partnership is a limited partnership and certain of its governance aspects are determined by laws relating to limited partnerships (including those relating to the potential loss of limited liability if limited partners participate in the control of the business of the Partnership) and the terms of the limited partnership agreement of the Partnership (the “Partnership Agreement”).

In accordance with the Partnership Agreement, the General Partner directs the operations of the Partnership. The Board of Directors of the General Partner is responsible for managing the business and affairs of the General Partner and the Partnership. The Board discharges its responsibility for the stewardship of the Partnership directly and through various committees. Management of the General Partner is responsible for the day to day conduct of the Partnership’s business, subject to oversight by the Board. Mr. David Fesyk, as President and Chief Executive Officer of the General Partner, has primary responsibility for day to day operations of the Partnership and for implementing business strategies and policies adopted by the Board. Mr. Fesyk reports directly to the Board. The Board retains responsibility for significant changes in the Partnership’s affairs, such as approval of major capital expenditures, financing arrangements, significant acquisitions and divestitures and those matters specifically set out in the Partnership Agreement as requiring Board approval.

The composition of the Board of the General Partner is prescribed by the Partnership Agreement, which provides that the Board shall be comprised of not greater than seven directors of whom not fewer than three shall be directors who are not officers, directors or employees of Koch Industries, Inc. or its affiliates (“Independent Directors”) and that if Koch Industries, Inc. and its affiliates own, directly or indirectly, less than 30% of the issued and outstanding units of the Partnership, not less than four of its directors shall be Independent Directors. The Board consists of four Independent Directors and three directors who are all employees of Koch Industries, Inc. or its affiliates. The Board has concluded that the four Independent Directors are unrelated directors within the meaning of the TSE guidelines. The Board has direct access to management and has the authority to seek advice from independent advisors, as necessary.

There are three committees of the Board: the Audit Committee, the Environmental, Health and Safety Committee, and the Compensation Committee.

The Audit Committee, has responsibility for, among other things, overseeing the nature and scope of the audit and recommending for Board approval the audited financial statements and other mandatory disclosure releases containing financial information, including the quarterly financial statements, and evaluating the accounting and financial reporting policies and internal controls of the Partnership.

The Environmental, Health and Safety Committee, has responsibility for, among other things, monitoring and approving the Partnership’s safety, environmental and emergency plans, procedures and controls.

The Compensation Committee, has responsibility for, among other things, assisting the Board by dealing with specific issues which may affect the compensation of senior officers and employees of the General Partner and the application of the compensation philosophy to employees of the General Partner who report through senior management. The Compensation Committee reviews the compensation packages of senior management personnel and makes recommendations on appropriate forms and levels of compensation for such employees to the Board.

Matters such as board orientation and education are the responsibility of the Board as a whole. Directors are nominated and elected by KPG Canada Ltd., the sole unitholder of the General Partner, subject to the requirement that certain members of the Board must be Independent Directors.

## Directors

### **RANDOLPH C. ALDRIDGE – *Chairman of the Board***

Mr. Aldridge is an independent businessman and energy industry consultant. He has over 25 years of engineering, marketing and management experience, including eight years as President of Koch Oil Co. Ltd. and Koch Canada, Inc. located in Calgary, Alberta, and three years as President of Koch Oil Company in Wichita, Kansas. Mr. Aldridge attended Texas A&M University where he received a Bachelor of Science degree in Chemical Engineering. He went on to earn a Master's degree in Management Science from the University of Texas at Dallas.

### **ANTHONY L. BOTTERWECK – *Director***

Mr. Botterweck has been employed by various Koch refining and pipeline affiliates for over 25 years. His experience has included accounting, planning, supply and distribution, business development and management. Mr. Botterweck has held the office of President in the General Partner's United States affiliate, Koch Pipeline Company, L.P., since 1998, having previously occupied the office of Vice President — Marketing in that same company. Mr. Botterweck graduated from Wichita State University in 1969 with a Bachelor of Science degree in Education.

### **DEREK BROWN – *Director***

Mr. Brown has been an Adjunct Professor of Finance in the Joseph L. Rotman School of Management and a Special Lecturer at the University of Toronto since October 31, 1996. Prior to that, Mr. Brown was Vice President and Director of RBC Dominion Securities Inc., an investment dealer.

# Partnership Information

### **DAVID E. DISHMAN – *Director***

Mr. Dishman is Managing Director, Corporate Finance for Koch Industries, Inc. Mr. Dishman joined Koch Industries, Inc., as Director, Corporate Finance and has since served in a number of controller/chief financial officer roles for various Koch businesses, including the Gas Liquids Group and the Capital Services Group. Prior to joining Koch, Mr. Dishman worked as an auditor with Ernst & Whinney, as Treasurer for The Moran Corporation, and has held various roles at Panhandle Eastern (now Duke Energy). Mr. Dishman is a graduate of Texas A&M University.

### **KEITH F. MILLER – *Director***

Mr. Miller is a Partner with the Calgary law firm Burnet, Duckworth & Palmer. He was admitted to the Alberta Bar in 1979 and since 1980 he has practiced regulatory law, principally before the National Energy Board and the Alberta Energy and Utilities Board.

### **R. T. (TIM) SWINTON – *Director***

Mr. Swinton is the President of Western Provinces Resources Ltd. and has served as a director of several public companies. Mr. Swinton has held a number of senior executive positions in both the service and producer sectors of the industry including Executive Chairman of IPEC Ltd. and Chairman and Chief Executive Officer of both Kenting Energy Services Inc. and EnServ Corporation.

### **DOUGLAS P. WILKINS – *Director***

Mr. Wilkins is Vice President and the General Manager of Crude Oil Supply and Trading with Flint Hills Resources, Ltd. Prior to joining Koch in 1995, Mr. Wilkins gained experience in products and crude oil trading and marketing management with Shell Canada Limited for nine years. Mr. Wilkins attended the University of Calgary and graduated in 1985 with a Bachelor of Commerce degree.

## Board of Directors

**RANDOLPH C. ALDRIDGE<sup>1&3&4</sup>**  
*Independent Businessman*

**ANTHONY L. BOTTERWECK**  
*President*  
 Koch Pipeline Company, L.P.

**DEREK BROWN<sup>3&4</sup>**  
*Adjunct Professor of Finance*  
 University of Toronto

**DAVID E. DISHMAN<sup>2</sup>**  
*Managing Director,*  
*Corporate Finance*  
 Koch Industries, Inc.

**KEITH F. MILLER<sup>2&3</sup>**  
*Partner*  
 Burnet, Duckworth & Palmer

**R.T. (TIM) SWINTON<sup>2&4</sup>**  
*President*  
 Western Provinces Resources Ltd.

**DOUGLAS P. WILKINS**  
*Vice President*  
 Flint Hills Resources, Ltd.

- <sup>1</sup> *Chairman of the Board*
- <sup>2</sup> *Member of Audit Committee*
- <sup>3</sup> *Member of Environmental,*  
*Health and Safety Committee*
- <sup>4</sup> *Member of Compensation Committee*

## Officers

**RANDOLPH C. ALDRIDGE**  
*Chairman of the Board*

**DAVID W. FESYK**  
*President and Chief Executive Officer*

**FRANK JANZEN, P.ENG.**  
*Vice President*

**CHRISTIAN P. BAYLE**  
*Vice President, Operations*

**SCOTT D. GERLA, CA**  
*Vice President, Finance*

**MARK P. WARD**  
*Treasurer*

**KATHERINE E. SIBOLD**  
*Corporate Secretary*

## Head Office

1400, 111- 5th Avenue S.W.  
 Calgary, Alberta, T2P 3Y6  
 Telephone: 403-716-7600  
 Facsimile: 403-716-7440

## Bankers

Bank of Montreal  
 Calgary, Alberta

Toronto-Dominion Bank  
 Calgary, Alberta

## Auditors

Ernst & Young LLP  
 Calgary, Alberta

## Registrar and Transfer Agent

Computershare Trust  
 Company of Canada

1800 McGill College Avenue  
 Montréal, Quebec H3B 3K9  
 Toll Free: 1-800-332-0095  
 Telephone: 514-982-7555

## Legal Counsel

Burnet, Duckworth & Palmer  
 Calgary, Alberta

## Stock Exchange Listing

The Toronto Stock Exchange  
 37,500,000 Class A Limited Partnership  
 units trading under the symbol KPC.UN

## Investor Relations Contact

**MARK P. WARD**  
*Treasurer*

Telephone: 403-716-7606  
 Facsimile: 403-716-7440  
 Email: investorrelations@kochind.com  
 Website: www.kcpepipelines.com

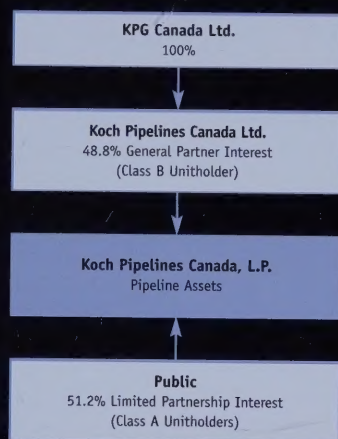
## Partnership Profile

Koch Pipelines Canada, L.P. (the "Partnership") is a publicly traded income fund which owns and operates four Canadian pipeline systems: the Bow River Pipeline System, the Koch Alberta Pipeline System, the Koch Valley Pipeline System in Alberta and the Mid-Saskatchewan Pipeline System in Saskatchewan. These pipeline assets gather crude oil from producer-owned production treating facilities (commonly known as batteries), truck terminals and other interconnecting gathering pipelines for delivery to regional refineries or major export pipelines. Combined, the systems comprise one of the largest crude oil feeder pipeline systems in Canada, totaling approximately 4,100 kilometres in length. In 2001, the pipelines had an average throughput of 235,000 barrels per day of crude oil and condensate. In addition, the Partnership holds a 15% interest in Cold Lake Pipeline Limited Partnership.

The general partner of Koch Pipelines Canada, L.P. is Koch Pipelines Canada Ltd. (the "General Partner"), a wholly-owned subsidiary of KPG Canada Ltd. ("KPG Canada"). KPG Canada is an indirect, wholly-owned subsidiary of Koch Industries, Inc. of Wichita, Kansas.

- Class A Limited Partnership units issued: 37,500,000  
Trade on the TSE under the symbol KPC.UN
- Class B General Partner units issued: 35,700,000

KPG Canada and its Canadian affiliates ("Koch Canada") have over 300 employees in Alberta, Saskatchewan and Ontario. Koch Canada's activities include heavy oil and gas exploration and production, crude oil supply and trading and crude oil transportation. Koch Canada has grown to become one of the largest purchasers, shippers and exporters of Canadian crude oil.



## Abbreviations


Bbl.....	barrel(s)
MMbbl .....	million barrels
Bbl/d .....	barrel(s) per day
WTI .....	West Texas Intermediate
Mbb/d .....	thousand barrels per day



Koch Pipelines Canada, L.P.  
1400, 111-5th Avenue S.W.  
Calgary, Alberta T2P 3Y6

[www.kpcpipelines.com](http://www.kpcpipelines.com)

Telephone: 403-716-7600  
Facsimile: 403-716-7440

  
Printed in Canada on stock  
that contains 10%  
post-consumer waste fibre.

